

The Property Tax Debate

“The word ‘property’ as used herein shall mean and include everything, whether tangible or intangible, subject to ownership.” Article VII, Section 1, *Washington State Constitution*

“The thing generally raised on city land is taxes.” Charles Dudley Warner (1829-1900)

Taxes Top Citizens’ Concerns

Ask citizens in Washington what concerns them about government and the most frequent answer will be taxes. Washington voters polled in May 1996, identified “issues related to the budget and taxes” as **most important** to them, and taxes were the issue mentioned most often.

A statewide poll taken in August 1995 showed how strongly the state’s voters want property tax relief. At the top of the list among “tax[es] that should be cut” was the tax people pay on their homes.

A less scientific but equally reliable indication of citizen unrest is the perennial filing of initiatives to roll back property taxes and limit their future growth. Two initiatives filed in 1996, for instance, are representative of growing discontent among property owners and their prescriptions for curing property-tax ills.

The frustration and anger of Washington’s citizens over rising property tax assessments can be traced to dramatic increases in levies that have outstripped inflation for more than a decade.

- Property taxes have grown about 40 percent faster than income since 1980.
- From 1985 to 1995, property taxes more than doubled.
- Homeowners bear the burden for more than half (64 percent) of all property assessments in Washington.

Older citizens trying to hang onto their homes, and young families struggling to buy their first home find it especially difficult to bear the weight of our growing property tax burden. In Washington, low- and middle-income families have begun to feel the strain of property tax assessments that have been rising faster than wages.

Homeowners want their property taxes cut. What’s more, they want the rate of increase slowed so the growth in property taxes does not exceed their incomes. At the same time, the state’s employers fear that tax relief for homeowners will shift the tax burden for funding local government programs onto commercial property assessments.

As property taxes have gone up in recent years, so has the number of proposals to give property owners relief. The complexity of Washington’s property tax laws, however, has confounded attempts to reform them.

State & Local Property Taxes in Washington

Washington has more than 1,700 taxing districts. These include: counties, cities, school districts, fire districts, library districts, ports, and emergency medical service districts. **Each taxing district levies property taxes based on the amount of money it wants to spend.** State law requires hearings on proposed tax increases by November 1 of each year. For the most part, assessors simply divide the total levy amount by the amount of taxable property in the district to determine the rate for the coming year.

After the sales tax, property taxes are the second largest source of state and local government revenue in Washington. Calculated separately, property taxes are the largest source of revenue for local governments and the third largest source of revenue for the state. Taxes on property account for 13 percent of total state revenues, or slightly more than \$1 billion per year. All levies on property combined cost Washington taxpayers more than \$4 billion annually.

Constitutional Requirements

By law, all real and personal property is subject to taxation in Washington unless it is specifically exempted. Real property such as land and buildings, however, account for the vast majority of property assessments. Personal property is everything except land and buildings. Over the years, specific exemptions have been provided for virtually all personal property (e.g. cars, household goods) in Washington. Certain business equipment and supplies are the only personal property currently subject to the tax.

The state Constitution mandates that similar property must be assessed equally and taxed at the same rate. This uniformity provision is a constitutional protection designed to ensure fairness among taxpayers. Stated simply, two pieces of similarly classified property must not only be taxed at the same rate, but their value also must be determined in the same way so that all taxpayers pay their fair share—and only their fair share—of a district's tax burden.

Under state law, most property assessments are made at 100 percent of market value or the amount a willing buyer would pay a willing seller. The exceptions to this rule are agricultural, open space and timberlands which may be assessed on the basis of current use. The assessment on most homes is calculated by determining comparable sales values on similar homes within a district. Such assessments are approximations rather than precise calculations. As a result, property is often assessed at less than 100 percent of true market value. The state Department of Revenue recently determined that statewide assessments represent 88 percent of market value.

The Tax on Intangibles

All property in Washington is subject to the property tax including intangible property such as business logos, so-called business goodwill, patents, licenses and a variety of other items not usually considered as property. Some of the intangibles currently exempt from the property tax include: money, mortgages, certificates of deposit, stocks, savings accounts and sports franchises.

Although some counties have eliminated the tax, the state's employers consider the tax a potentially dangerous "sleeping dog" that if awakened could take a bite out their profits. Taxing intangibles is not only subject to arbitrary measurement, say opponents, it could be a job-killing disincentive to doing business in Washington State.

One recent case gives credence to employers' concern. The assessor in Grays Harbor County assessed a local McDonald's franchise an intangibles tax based on the value of the McDonald's logo. This heightened interest in erasing the tax from the books statewide and gave rise to HB 2745 in 1996 to do just that.

Shifting the Burden

County assessors may revalue property up to once a year or only once every four years. They must, however, revalue property on a regularly established cycle. Most homeowners are familiar with the tax

increases that frequently follow revaluation. When some property is revalued and other property is not, the result is a shift in tax burden among various property owners. Residential property owners, for instance, have paid an increasing share of property taxes compared to commercial property owners since 1991. This shift occurred because of the real estate boom that began driving up home values in 1990.

Limits on Taxation

The state Constitution limits property taxes to 1 percent, or \$10 per \$1,000 of value, without a vote of the people. Taxes levied under this constitutional limit are **regular** levies. Regular levies are subject to certain limits. There is a statutory limit on the maximum **rate**. In addition, total revenue **collections** are limited to 106 percent¹, and there is a limit on the **total rate** imposed by all districts. The total amount that may be levied under these limits is \$5.90 per \$1,000 of assessed value not including the state, port district levies, and utility district levies.

Voter-Approved Tax Increases

To be fair, voters have themselves to blame for some of the increase in property taxes. In fact, voter-approved excess levies during the last two and a half decades have been a major contributing factor to rising property taxes. Special or “excess” levies may be approved by voters and are added to regular levies.² The statewide average for total property taxes including both regular and special levies in 1995 was \$13.53 per \$1,000 (\$3.57 state, \$5.34 local regular levies and \$4.62 for voter-approved excess levies).

Property-tax Relief

Providing taxpayers with meaningful property-tax relief is especially difficult because schools and local governments depend so heavily on property taxes to balance their budgets. As a result, any change in the rate or assessment on one class of property shifts the burden for funding local budgets onto other types of property. Efforts to lower the property tax in Washington invariably meet with resistance from those who would bear the added burden resulting from tax cuts granted to other property owners.

Business owners, for instance, oppose relief plans that single out residential property for tax cuts since the reduced assessment for homeowners would result in a shift of the tax burden onto commercial property. Local government officials similarly oppose any change that cuts deeply into their primary source of revenue.

Senior Citizen Property Tax Exemptions

The only bona fide property tax relief on the books in Washington partially exempts low-income seniors and persons retired on disability from paying state and local levies on their homes. Those 61 years of age or retired due to physical disability with household incomes of less than \$28,000 qualify for exemptions from special levies and, in some cases, regular levies.³ In addition, the property value of qualifying homeowners was frozen at 1995 levels for those already on the program or, for those who qualify after 1995, the market value on Jan. 1 of the year they qualify.

The state also provides property tax deferrals for some qualifying, low-income seniors and disabled retirees. The deferral program’s effect on revenues is negligible since fewer than 2,000 people statewide take advantage of the program. Deferrals, as the low participation rate confirms, are not tax relief. They simply allow property owners to delay their tax payments.

The 106-percent Limit

Local taxing districts in Washington had a virtual carte blanche to increase taxes at one time and spending decisions were driving tax rates upward. Washington legislators tried to put the brakes on property tax increases in 1971 with passage of the 106-percent limit. Under this proposal, taxing districts could levy no more than 106 percent of the highest tax levied in the preceding three years.⁴

The 106-percent limit is frequently misunderstood. It restricts the total levy within a district, not the taxes levied against any single parcel of property.

Recent history is testimony to the limit's failure to slow tax increases. In 1970, inflation was about 6 percent and so the limit was set at 106-percent to represent inflation. Over the past 10 to 15 years, however, taxing districts have been authorized to increase property taxes by 6 percent each year even though inflation — and income — have risen at a much slower annual rate.

A proposal introduced in 1995 (SB 5347)⁵ attempted to solve the problem by limiting the total value of property tax collections to 106 percent of the previous year's collections **or inflation, whichever is lower.**

The effect of this proposal on areas with rapidly growing property values would have been a slowdown in the growth of property tax increases. Areas where values were not growing as rapidly would not have been affected since they already would have bumped up against statutory limitations. Since this proposal attempts to adjust the limit on the total value of tax collections, taxing districts would collect less revenue and all taxpayers would benefit from lower levies.

The state would have collected approximately \$75 million less in the current biennium if SB 5347 had become law, and local levies would have been reduced by an estimated \$70 million. The legislation predictably met with opposition from local government. Testimony in committee from representatives of local taxing districts contended law enforcement and social services would suffer under the proposal. Existing services, they said, could not be maintained at current levels.

Reducing or Eliminating the State Levy

The state property tax amounted to 40 percent of regular property taxes and more than 25 percent of total assessments in 1995. Reducing or eliminating the state share has strong appeal because it has the potential to provide meaningful relief to residential and commercial property owners without reducing local revenues.

The state's share of property tax assessments in Washington is often referred to as the state school levy because it replaced the local regular school levy in 1975. Revenue collections from the state levy, however, are placed in the general fund.

In recent sessions, a number of proposals have been introduced to eliminate the state property tax.

Attempts to provide minor relief to property owners this year by overriding the governor's 1995 veto of HB1957, a plan to phase out the state property tax, failed due to resistance by majority Democrats in the Senate. As a result, HB 2841 was introduced this year to lower 1997 property taxes by 9.7 percent. The measure would have given taxpayers a \$66 million tax cut in the current budget period.

- The legislation included a permanent 5-percent reduction in the state share of the property tax. Majority Democrats in the Senate did not take action on the bill until moments before the Legislature adjourned. By the time the proposal was transmitted to the state House of Representatives, the session was over and taxpayers were forced to wait another year for property-tax relief.

- In an effort to avoid a threatened veto, Senate Republicans tried to amend the bill with a referendum clause. The amendment failed on a party-line vote.

Another measure introduced in 1995, SB 5000 sponsored by Democrat Sen. Valoria Loveland, created a Property Tax Reduction Fund. All excess revenues above the state's voter-approved Initiative 601 spending limit were to be deposited in the fund and used to reduce the state property tax levy.

- This proposal ran into legislative opposition on two fronts. First, the promised tax reduction was just that: a promise. The plan included no guarantee that "excess" revenue would ever find its way into the Property Tax Reduction Fund. Second, many lawmakers saw the proposal as a Trojan horse to begin tinkering with I-601.
- One indication that the bill's proponents were less than fully committed to reducing property taxes was the failure of a Republican-sponsored amendment to the bill offered by Sen. Shirley Winsley. The Winsley proposal would have reduced the \$3.60-per-\$1,000 state property tax by 60 cents per year for six consecutive years until it was eliminated. The amendment failed on a party-line vote.
- SB 5000 eventually was amended and passed to provide a one-time, 4.7 percent reduction in the state property tax for 1996 taxes.

Residential Credits: Tax Relief Without a Tax Shift

Taxpayers — especially homeowners on fixed incomes — need tax cuts if homeownership is going to remain affordable in the future. At their current rate of growth, property taxes double in less than eight years. That's a growth rate four times faster than the growth in real wages. People on fixed incomes actually experience a decline in income as a result of inflation.

The most difficult problem in delivering real relief to homeowners is the potential shift in taxes from residential property to commercial property. Residential tax credits offer a solution to the problem. A proposal (SB 6777) was offered in 1996 that would have given a credit to homeowners for their first \$21,750 of property value. Because the credit is subtracted from the tax owed on residential property, there is no shift in the tax burden.

- If the bill had been enacted, the result would have been an immediate savings of approximately \$100 every year for homeowners across the state.
- Bill sponsor Sen. Dan Swecker accompanied this measure with a constitutional amendment to account for the different treatment of residential and business property. Many observers, however, argue that the constitutional amendment is not necessary because rates and assessments for both residential and commercial property remain the same under provisions of the legislation.

California's Proposition 13

The best known property-tax revolt in modern times occurred at the polls in California with passage of Proposition 13 in 1978. This constitutional relief package capped property taxes for Californians at 1 percent and rolled back assessed values to 1975-76 levels. "Prop 13" also limited future increases to 2 percent annually except that property is reassessed at true value whenever ownership is transferred.

- Most of the media and political interest groups at the time warned of dire consequences to such public services as education and police and fire protection if voters were reckless enough to approve

Proposition 13. California voters **did approve** the property-tax cut and, despite the predictions of impending calamity, California has not yet been reduced to third-world status.

Property-Tax Initiatives

Initiative 657

This **initiative to the people** failed to receive a sufficient number of signatures by the July 5 deadline to be certified for the November 1996 ballot. The provisions of I-657, however, are representative of citizen-sponsored tax relief proposals that have gained currency since the 1970s.

- The initiative proposed a rollback of all taxes to 1992 levels and a limit on assessment increases to 2 percent per year or the cost of living, whichever is lower.
- A provision that some argued would not pass constitutional muster would have eliminated state property taxes on primary residences, but not on commercial property.
- The initiative additionally would have limited increases to no more than .5 percent per year after 1997 and would have cut current tax limits on a primary residence in half, to \$5 per \$1,000 of value.

Initiative 184

This **initiative to the Legislature** would freeze property values at 1995 levels and gradually reduce tax levy increases to 2 percent per year. Under provisions of this initiative sponsored by Rep. Steve Hargrove, 1995 would become the base year for establishing the true and fair value of property. Increases would be limited to 5 percent in 1998 and 4 percent in 1999 until the permanent limit of 2 percent takes effect in the year 2000.

- Signatures on initiatives to the Legislature must be validated by the Secretary of State on or before Jan. 3, 1997 for the initiative to be certified. It currently takes 181,667 valid signatures for an initiative to be certified.
- Once certified by the Secretary of State, the Legislature may enact the measure, amend it (in which case both the original proposal and the amended version go to the ballot) or take no action and let the voters decide on the issue.

¹ Regular property tax levies of taxing districts are limited to 106 percent of the highest levy in the three preceding years plus the amount of revenue that new construction, improvements to the property, and changes in state-assessed property would have generated at the preceding year's tax rate.

² The 1 percent limit may be exceeded if approved by 60 percent of the voters voting on the proposition provided the "yes" vote equals at least 24 percent of the number of votes cast in the last general election. Levies used for capital purposes must receive "yes" votes equal in number to at least 40 percent of the voters voting in the taxing district in the last general election.

³ Qualifying seniors with annual household income less than \$15,000 are exempt from all special levies and regular levies on the greater of \$34,000 or 50 percent of the assessed value. Those with incomes between \$18,000 and \$15,000 are exempt from special levies and a portion of regular levy assessments. Qualifying homeowners with incomes between \$28,000 and \$18,000 are exempt from special levies.

⁴ Districts also take into account the previous year's tax rate applied to the value of new construction and improvements (see endnote No. 1).

⁵ Senate Bill 5347 was sponsored by Senators Cantu, Oke, Johnson and West. This concept, which has been introduced in previous legislative sessions, also appeared in legislation proposed in the House of Representatives.